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Office-Supreme Court, U.S.
FILED
MAR 24 1983
ALEXANDER L. STEVAS
CLERK

No. 82-215

In The

Supreme Court of the United States

OCTOBER TERM, 1982

UNITED STATES OF AMERICA,

Petitioner,

v.

WHITING POOLS, INC.

On Writ Of Certiorari To The United States Court Of Appeals For The Second Circuit

BRIEF FOR RESPONDENT WHITING POOLS, INC.

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In The

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OCTOBER TERM, 1982

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UNITED STATES OF AMERICA,

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v.

WHITING POOLS, INC.,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Second Circuit

BRIEF FOR RESPONDENT WHITING POOLS, INC.

STATUTES INVOLVED

Sections 541(a) and 542(a) of the Bankruptcy Code, (11 U.S.C. (Supp IV)) and Section 6331 of the Internal Revenue Code (26 U.S.C) are set forth in Pet. App. 52a-56a. Sections 105(a), 106, 361, 363(a), (b), (c) (1), (2) and 543 (b) (1) of the Bankruptcy Code, Sections 6332(a); 6335; 6337; 6338; 6339(a) (1), (2), (b); 6342(b) of the Internal Revenue Code, and 28 U.S.C. §1471(e) and 1651(a) are set forth in Respondent's Appendix A, attached.

STATEMENT OF CASE

Petitioner's statement of the case is substantially accurate, though it makes some omissions which we wish to note for the Court.

In ordering the turnover at issue, the bankruptcy court below made several findings of fact that are not controverted, to wit:

1. Whiting's indebtedness to the IRS for unpaid employment taxes is approximately $92,000.00;

2. The seized assets have a going concern value of $162,876.00;

3. Other than the IRS tax lien, the only existing lien against the seized assets was a security interest owned by Marine Midland Bank in the amount of either $6,000.00 or $12,500.00.

4. Based on the above, the debtor has a substantial equity in the seized property.

5. Public sale of those assets by the IRS will yield a *maximum* of $30,000.00. — $35,000.00

(Pet. App., 35a-36a). The bankruptcy court concluded, based on these findings, that "the seized property is absolutely necessary to an effective reorganization of the debtor" since "the debtor will cease to exist" once the sale occurs. (Pet. App., 36a) Accordingly, the bankruptcy court determined that turnover is in the best interest of the government, since the IRS would recover more on its tax claim from a successfully reorganized business than from a tax sale, and its interest could be adequately protected in the interim. These factual conclusions have not been disputed by the government.

In fashioning adequate protection for the government, the bankruptcy court ordered Whiting to pay the IRS $20,000 upon the return of the seized property and to make further payments of $1,000 per month until the tax was paid. The court further

permitted IRS to retain its lien upon the seized property and provided for the lifting of the automatic stay in the event Whiting defaulted in payment. (Pet. App. 44a-45a). Although some $15,000 of the initial payment of $20,000 was to come from a bank account also subject to a pre-petition levy by the IRS (Pet. Br. p.4, n.1), the account merely was part of the total collateral held by the IRS at the time of the petition, in addition to the seized tangible assets which were worth $162,876. The power of the bankruptcy court to utilize such bank account funds as part of IRS's adequate protection remedy is coextensive with its general turnover powers which are at issue in this case.

SUMMARY OF ARGUMENT

A. Whether tangible property seized by the government by pre-petition tax levy is subject to the §542(a) turnover power of the bankruptcy court in a reorganization proceeding turns upon whether such property is "property that the trustee may use, sell or lease under Section 363". Section 363 authorizes the use, sale or lease of "property of the estate". Courts which have held that the government is beyond the scope of the turnover power have construed the phrase "property of the estate" rigidly as a term of art defined in §541(a) as "all legal or equitable interests of the debtor in property as of the commencement of the case." In this view, the turnover requirement extends only to the debtor's *interests in property;* so that the debtor's *right to possession,* at the commencement of the case, or lack thereof, is determinative of the trustee's right to turnover. The Second Circuit, like other courts which have permitted the turnover power to be employed against the government, recognized that turnover applies not to *interests* in property *per se* but to the property itself, so that under §542(a), a trustee may obtain possession of *assets* in which the debtor holds a substantial interest, subject only to the requirement that the interests of other parties in those assets be adequately

protected. The latter approach is, we believe, more consistent with the basic rehabilitative purpose of the Bankruptcy Code and applicable precedent in reorganization cases.

B. Under the government's construction of §§542(a), 541 and 363 of the Bankruptcy Code, the scope of turnover power is delimited by the debtor's non-bankruptcy interests in property, particularly the right of possession of that property. Since no meaningful distinction exists between the right of secured creditors to possession of repossessed collateral and the right of the government to possession of property seized by tax levy, the rule advocated by the government would place property repossessed by secured creditors beyond the reach of the turnover power.

C. In our view, *Phelps v. United States*, 421 U.S. 330 (1975) and other cases decided under the Bankruptcy Act which held that a trustee or receiver in bankruptcy was not entitled to obtain a turnover of property which the IRS had seized from a taxpayer prior to that taxpayer's bankruptcy are not meaningful precedent in this case. The earlier cases involved liquidation or Chapter XI proceedings in which, under the Bankruptcy Act, a determination that property was held adversely by a third party under a claim of right was sufficient to defeat the limited "summary" jurisdiction of the bankruptcy court, particularly where no statutory turnover power was provided in the Act. The elimination of the distinction between summary and plenary jurisdiction in the Bankruptcy Code, the pervasive jurisdictional grant to the bankruptcy court under 28 U.S.C. §1471(e), and the express grant of turnover power under 11 U.S.C. (Supp. IV) §542(a) all combine to make the earlier decisions under the Bankruptcy Act no longer relevant, particularly in reorganization cases under the Bankruptcy Code.

Despite the government's attempt to assert that *Phelps v. United States* and other Bankruptcy Act cases stand for the proposition that a tax levy, by itself, actually effects a transfer

of ownership of the property levied upon from the taxpayer to the government, neither the cases relied upon nor the applicable statutes so provide. None of the cases dealt with the "ownership" of *tangible* property post-seizure but prior to sale under levy, and the applicable sections of the Internal Revenue Code make it clear that the taxpayer remains the owner of seized tangible property until a sale is actually conducted and a certificate of sale or deed is delivered to the successful bidder. *Phelps* and the other pre-Bankruptcy Code cases relied upon by the government are neither applicable to the statute whose construction is at issue herein nor to the facts involved in this case.

D. Adoption of the government's superficial construction of the relevant statutes is not compelled by the plain meaning rule. That rule is not a rule of law, but an "axiom of experience" and, as such, did not bar the Court of Appeals from considering the circumstances of the enactment of §542(a). In any event, reference to extrinsic aids is necessary because the key phrase "property of the estate", as employed in §363, is ambiguous in that it appears from the context of §363 to refer to *items of property* capable of use and capable of being encumbered, yet it apparently could refer to the interests in property which comprise the estate under §541(a)(1). In addition, the "plain meaning" urged by the government yields the absurd and unreasonable result that turnover under §542(a) would be restricted to recovery of *interests* of the debtor in the "possession" of third party, when such interests are already brought into the estate by §541(a). Furthermore, resort to extrinsic aids to ascertain legislative intent was proper because the "plain meaning" urged by the government produces an unreasonable result contrary to the rehabilitative purpose of the Bankruptcy Code — a turnover power too restricted in scope to enable a bankruptcy trustee to recover property rightfully held by a secured creditor regardless of the extent of the debtor's equity or the impact on reorganization.

E. As the Court of Appeals found, §542(a) suddenly appeared in final form in H.R. 6, a draft prepared immediately after the completion of House subcommittee hearings in which every witness to address the question recommended that a provision be added to clarify that the broad turnover power applicable in reorganization cases under Chapters X and XII of the Bankruptcy Act is to be incorporated in the new Bankruptcy Code. The timing of the addition of §542(a) thus compels the inference that Congress intended to codify *Reconstruction Finance Corp. v. Kaplan,* 185 F.2d 791 (1st Cir. 1950), and subject secured creditors holding repossessed collateral to the turnover requirement. No alternative explanation of the origin of §542(a) is supported by the legislative history, and no clear statement of legislative intent to the contrary appears in either the legislative debates or the committee reports.

F. Bankruptcy Code §542(a) was intended by Congress to be a codification of the broad turnover power which had developed in Chapter X reorganization cases under the Bankruptcy Act as exemplified by the holding in *Reconstruction Finance Corp. v. Kaplan.* The primacy of the goal of rehabilitation in reorganization cases is apparent in the legislative history and explains the enactment of a comprehensive turnover power as an adjunct to the generally expanded jurisdiction of the bankruptcy court granted by the Bankruptcy Code. The narrow construction of §542(a) advocated by the government would appear to make turnover unavailable even under the facts of *Reconstruction Finance Corp. v. Kaplan,* a result clearly not intended by Congress.

G. In a reorganization case under the Bankruptcy Code, such as the present one, where the retention of possession by a third party of property essential to the debtor-in-possession's business operations will thwart an effective reorganization, the real issue should be whether the interests of the third party in

the property can be "adequately protected" if possession of the property is turned over to the debtor-in-possession.

The applicable statutory provisions, Bankruptcy Code §§361 and 363(e), and their legislative history, clearly envision broad equitable power in the bankruptcy court in this regard which was to be flexible enough to deal with the facts of each case on a case-by-case basis.

The determination of the bankruptcy court below that the seized property was essential to Whiting's ability to operate as a debtor-in-possession and that the interests of the IRS could be adequately protected by specific requirements which it imposed upon Whiting was consistent with the manner in which the bankruptcy court was intended to function under the Bankruptcy Code. Accordingly, the turnover order which was issued by the bankruptcy court against the IRS in this case was within its statutory powers.

ARGUMENT

A Bankruptcy Court in a Reorganization Proceeding under the Bankruptcy Code may require any creditor, including the government, in possession of tangible property in which the debtor retains a substantial interest, to turn over that property to the debtor-in-possession if the property is necessary to the debtor's reorganization and the interest of the creditor in the property can be adequately protected.

A. *Background.*

Section 542(a) of the Bankruptcy Code requires "an entity, other than a custodian, in possession, custody, or control, during the case, of property that the trustee may use, sell or lease under Section 363 of this title" to turn over that property to the trustee unless it is "of inconsequential value or benefit to the estate." 11 U.S.C (Supp. IV) §542(a). The ultimate issue on this appeal is a narrow question of construction of §542(a): whether, in a reorganization proceeding, tangible assets of a debtor in the possession of the IRS following a pre-petition tax levy are subject to turnover under §542(a) of the Bankruptcy Code, 11 U.S.C. (Supp. IV) §542(a), as "property that the trustee may use, sell or lease under Section 363" of the Bankruptcy Code, 11 U.S.C. (Supp. IV) §363.[1] By the terms of §363, the trustee is authorized to use, sell or lease "property of the estate," 11 U.S.C. (Supp. IV) §363(b), (c) (1); subject to the requirement that the bankruptcy court, at the request of an

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[1]The government concedes, as it must, that the IRS is a "governmental unit", and thus an "entity" as defined in 11 U.S.C. (Supp. IV) §101 (14). Pet. Br. at 14, n.4. The District Court ruled, and the Second Circuit agreed, that the IRS is not a "custodian" within the meaning of paragraph 10 of §101 of the Bankruptcy Code, 11 U.S.C. (Supp. IV) §101(10), and thus is not subject to the turnover requirement of §543, 11 U.S.C. (Supp. IV) §543(b). Pet. App. at 48a-50a; 8a-10a. It is undisputed that the IRS, as an entity, would be subject to the turnover requirement of §542(a), if it had possession, custody or control of property that the trustee may use, sell or lease.

entity with an interest in the property, "shall prohibit or condition such use, sale or lease as is necessary to provide adequate protection of such interest". 11 U.S.C. (Supp. IV) §363(e). The phrase "property of the estate" is not actually defined in §363, although §541 of the Bankruptcy Code (which bears the heading "Property of the estate") provides, in relevant part, that the bankruptcy estate is comprised of "all legal or equitable interests of the debtor in property as of the commencement of the case".[2] 11 U.S.C. (Supp. IV) §541(a) (1).

This statutory scheme is capable of, and has been subjected to, at least two plausible, but conflicting interpretations. One view, typified by the decision of the Fourth Circuit in *Cross Electric Co. v. United States*, 664 F.2d 1218 (4th Cir. 1981) and urged by the government here, holds that the phrase "property of the estate", as employed in §363 of the Bankruptcy Code, is a term of art defined by 11 U.S.C. (Supp. IV) §541(a) (1) as "all legal or equitable interests of the debtor in property as of the commencement of this case." Thus, it is argued that since the property which may be used, sold, or leased under §363 is limited to "property of the estate", only those *interests of the debtor in property* as of the date the petition was filed are subject to turnover under §542(a) of the Bankruptcy Code. Pet. Br. at 14-16, 19. Where the debtor's *interests* in an asset did not include the right to possession and use of the property at the commencement of the case, the courts espousing this view have denied turnover.[3]

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[2]Of course, a bankruptcy case is commenced by the filing of a petition. See, 11 U.S.C. (Supp. IV) §§301; 302(a); 303(b); 541(a).

[3]See, e.g., *Cross Electric Co. v. United States*, 664 F.2d 1218, *supra; In re Avery Health Center, Inc.*, 7 B.C.D. 210, 212 (W.D.N.Y. 1981); *Parker GMC Truck Sales, Inc. v. United States*, 6 B.C.D. 899, 900 (Bankr. S.D. Ind. 1980); *In re Winfrey Structural Concrete Co.*, 6 B.C.D. 695 (Bankr. D. Colo. 1980); *Bush Gardens, Inc. v. United States*, 5 B.C.D. 1023

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The competing view, to which the Second Circuit adheres, interprets §542(a) as imposing a requirement that third parties in possession, custody or control of *property in which the debtor had a substantial legal or equitable interest* as of the commencement of the case turn over that property to the trustee or debtor-in-possession.[4] *See, United States v. Whiting Pools, Inc.*, 674 F.2d 144, 149-56 (2d Cir. 1982); Pet. App. at 11a-23a. Courts adopting this construction of the statute have found support for a broad turnover power in the legislative history of the Bankruptcy Reform Act of 1978, the expanded jurisdiction of the Bankruptcy Court under that Act, and, more particularly, in a perception that Congress, especially in reorganization cases, could not have intended the consequences that flow from an overliteral construction of the phrase "property of the estate".[5] In this view, the words "property of

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(D. N.J. 1979); *In re Paukner*, 10 B.R. 29 (Bankr. N.D. Ohio 1981); *Douglas v. United States*, 7 B.C.D. 690 (Bankr. D. Neb. 1981), overruled in *In re Cudaback*, 22 B.R. 914, (Bankr. D. Neb. 1982); *In re Bishop & Son, Inc. v. IRS*, 19 B.R. 633 (W.D. Mo. 1982); *In re Birco Mining Co.*, 8 B.C.D. 795 (N.D. Ala. 1981); Cf. *In re Cyber Electric Co.*, 18 B.R. 921 (Bankr. E.D. Mich. 1982) (seizure of cash distinguishable from seizure of tangible property in that debtor retains no interest in case that could be turned over to the trustee).

[4]Under 11 U.S.C. (Supp. IV) §1107(a), a debtor in possession, with certain exceptions not relevant here, has all the rights, powers and duties of a trustee.

[5]*See, United States v. Whiting Pools, Inc.*, 674 F.2d 144, 149-56; *supra* Pet. App. at 11a-23a; *In re Aurora Cord & Cable Co.*, 2 B.R. 342 (Bankr. N.D. Ill. 1980), aff'd. No. 80-C-396 (N.D. Ill. Dec. 1, 1981) (unpublished opinion); *Alpa Corp. v. IRS*, 7 B.C.D. 791 (Bankr. D. Utah 1981), appeal pending, No. C81-0490J (D. Utah); *In re Sunrise Equip. & Dev. Corp.*, 24 B.R. 26 (Bankr. D. Ariz. 1982); *In re Health America of Florida, Inc.*, 22 B.R. 268 (Bankr. M.D. Fla. 1982); *In re Day Resource & Dev. Co.*, 21 B.R. 176 (Bankr. D. Idaho 1982); *In re Hudson Valley Ambulance Serv.*, 11 B.R. 860 (Bankr. S.D.N.Y. 1981); *Bristol Convalescent Home, Inc. v. IRS*, 7 B.C.D. 1151 (Bankr. D. Conn. 1981); *In re King*, 7 B.C.D. 530 (Bankr.

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the estate", as employed in subsections (b) and (c) of §363, are intended to refer to *assets* of the bankruptcy estate rather than to the debtor's *property interests* in those assets. Once the bankruptcy estate succeeds to the debtor's legal or equitable interests in a given asset by operation of §541(a) (1) of the Bankruptcy Code, the bankruptcy court obtains equitable jurisdiction over that entire asset, *See*, 11 U.S.C. (Supp. IV) §105; 28 U.S.C. §1471(e); 28 U.S.C. §1651; and that asset, though encumbered by the property interests of third parties, becomes property which the trustee may use, sell or lease within the meaning of §§363 and 542(a) of the Bankruptcy Code. As long as the debtor retained, at the filing of the petition, a substantial interest in an asset (such as the right to redeem property following a tax levy under 26 U.S.C. §6337 or the right, under U.C.C. §9-506, to redeem repossessed collateral, or a substantial equity in the property), the encumbered asset would be subject to turnover under §542(a) of the Bankruptcy Code, even though the third party holding the property would have the right to possession absent the pendency of the bankruptcy case. See, *United States v. Whiting Pools, Inc., supra,* at 151, 156-57; Pet. App. at 12a-13a; cf. *International Horizons, Inc.*, 21 B.R. 414 (Bankr. S.D. Fla. 1982) [debtor's insurable interest in finished goods under U.C.C. §2-501(1) too insignificant to render entire property subject to turnover]. Where the interest of that third party could not be adequately protected, however, turnover would be denied. See, 11 U.S.C. (Supp. IV) §§361, 363(e).

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M.D. Tenn. 1981); *Barsky v. Commonwealth of Pennsylvania*, 6 B.C.D. 1216 (Bankr. E.D. Pa. 1981); *Troy Indus. Catering Serv. v. Michigan*, 2 B.R. 521 (Bankr. E.D. Mich. 1980); *Accord, In re Dartmouth Nursing Home, Inc.*, 24 B.R. 256, 265 (Bankr. D. Mass. 1982); *In re Cudaback*, 22 B.R. 914, *supra*, note 3; *In re Debmar Corp.* 21 B.R. 858, 860 (Bankr. S.D. Fla. 1982); *In re International Horizons, Inc., supra* at 417; *In re Hurricane Elkhorn Coal Corp.*, 19 B.R. 609, 618 (Bankr. W.D. Ky. 1982).

Comparison of these two competing viewpoints can yield but one conclusion: that the Court of Appeals was correct in rejecting the Government's superficial and strained construction of the language of §§542, 541(a) (1) and 363 of the Bankruptcy Code in favor of a broad view of §542's turnover power consistent with the settled law of business reorganizations, the policy of the Code favoring the rehabilitation of business debtors, the intended function of the bankruptcy court as a court of equity balancing competing interests by the use of the concept of adequate protection, the legislative history of §542(a), and the language of the relevant statutes. The core concept in the government's position — that non-debtors holding a possessory interest in property of the debtor as of the filing date of a bankruptcy petition are immune from the turnover power of the bankruptcy court — is simply untenable in light of the legislative history and the drastic impact such a rule would have on the prospects for successful rehabilitation of business debtors and the ability of any debtor to use encumbered property.

B. ***For Purposes Of Turnover Under §542(a), There Is No Meaningful Distinction Between The Posture Of The IRS Following A Pre-petition Tax Levy And That Of A Secured Creditor Or Pledgee In Possession Of Collateral Following The Default Of The Debtor.***

The crux of the government's argument is that the "plain meaning' of §§541, 542 and 363 of the Bankruptcy Code dictates that only where the debtor's interests in property pre-petition included the right to possession is such property subject to turnover. Pet. Br. at 12-29. Arguing that under the Internal Revenue Code, 26 U.S.C. §6331 *et. seq.*, the limited rights remaining to a taxpayer following seizure of its assets by tax levy do not include the right to use and possession of the seized property, the government concludes that the Bankruptcy Code does not require the IRS to turn over such property. Pet. Br. at 22-23.

Since the relevant provisions of the Bankruptcy Code make no distinction between the IRS and other entities, this rationale would be equally applicable to any "entity" in possession of the debtor's property under a claim of right. *See*, 11 U.S.C. (Supp. IV) §542(a). A secured party who has repossessed property of the debtor prior to bankruptcy has the right to possession of its collateral under §9-503 of the Uniform Commercial Code,[6] just as the IRS, under §§6331(a) and 6332(a) of the Internal Revenue Code,[7] has the right to possession of property seized by tax levy. Under the theory urged by the government, it is the nature and extent of the debtor's non-bankruptcy interests in property that determines whether that property is subject to turnover. Since this theory holds that the existence or non-existence of a possessory interest in the debtor ultimately determines whether a particular item of property must be turned over, no meaningful distinction can be made between a possessory interest that has been forfeited to the IRS prior to bankruptcy by tax levy under the Internal Revenue Code, and a possessory interest that has been forfeited to a secured creditor by repossession under state commercial

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[6]UCC 9-503 provides, in relevant part, that "[u]nless otherwise agreed a secured party has on default the right to take possession of the collateral."

[7]Section 6331(a) of the Internal Revenue Code, 26 U.S.C. §6331(a), gives the Secretary of the Treasury the right to collect a delinquent tax "by levy upon all property and rights to property . . . belonging to" the taxpayer. The Internal Revenue Code defines "levy" as including "the power of distraint and seizure by any means". 26 U.S.C. §§6331(b); 7701(a)(21). Section 6332(a) of the Internal Revenue Code requires "any person in possession of . . . property or rights to property subject to levy upon which a levy has been made" to "surrender such property or rights" to the IRS on demand.

law.[8] It follows that if the government's construction of the relevant statutes is correct, the bankruptcy court would lack the power to displace from possession not only the IRS holding property seized by tax levy, but also a secured creditor holding collateral repossessed from the debtor[9] or a pledgee holding the debtor's pledge after default[10], regardless of the extent of the debtor's equity in such property.

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[8]The government points to several differences between private secured creditors and the tax collector, none of which alter this conclusion. The nonconsensual nature of a tax levy does not enlarge the IRS' right to possession of seized property; nor does the consensual nature of a secured transaction diminish the secured creditor's right to possession upon default. If anything, the fact that the IRS is entitled to levy upon all property belonging to the taxpayer, 26 U.S.C. §6331(a), while a secured creditor generally obtains a security interest in the collateral or classes of collateral specified in a security agreement, *See,* U.C.C. §9-203, suggests that the IRS' property interest in any particular item is less necessary of protection than a secured creditor's would be. In any event, the fact that the IRS has greater collection remedies available to it does not distinguish the government's right to possession of seized property from that of a secured creditor in possession of collateral following default.

[9]In fact, at least one court has already extended the rule of *Cross Electric Co. v. United States,* 664 F.2d 1218, *supra,* beyond the limited context of a tax levy. See, *In re Campbell,* 20 B.R. 42 (Bankr. D.S.C. 1982); In *Campbell,* the bankruptcy judge held that an automobile repossessed by a secured creditor prior to bankruptcy was not subject to turnover under §542(a). *Id.*

[10]"A pledge is a security interest in a chattel or in an intangible . . . created by a bailment for the purpose of securing the payment of a debt or the performance of some other duty." RESTATEMENT OF SECURITY §1 (1941). Under the Uniform Commercial Code, after default, the rights of a pledgee to the collateral are identical to those of a non-possessory secured party who has repossessed such collateral: *See,* ALI, UCC§9-501, Comment 2 (1978 Official Text with Comments). *See also,* U.C.C. §§9-501(1); 9-502, 9-504, 9-505.

C. *Cases Decided Under The Bankruptcy Act Which Denied Turnover Against The Internal Revenue Service Are Not Meaningful Precedent Under The Bankruptcy Code.*

Although private creditors may be subject to turnover under §542(a) of collateral acquired by them from the debtor pre-petition, the government here claims that it is excepted from such requirement either because the nature of an IRS levy has been judicially determined to transfer "ownership" of levied property to the government,[11] or because, in its view, existing law prior to the Bankruptcy Code did not require turnover by the government of property seized pre-petition by the IRS and no evidence exists that Congress intended to effect such a change in enacting the Bankruptcy Code.[12] Either argument takes its genesis from the decision of this Court in *Phelps v. United States*, 421 U.S. 330 (1975), as well as certain of the prior decisions cited therein.[13] Because of its preeminence as the primary cited authority in all of the post-Bankruptcy Code court decisions denying turnover versus the IRS, with the inexplicable exception of the Fourth Circuit's decision in *Cross Electric, supra*, it would not be amiss to characterize *Phelps* as the standard upon which the government has raised its flag to do battle with turnover. But are *Phelps* and the related pre-Code cases decided on its authority really relevant to issues raised under the Bankruptcy Code? We respectfully submit that the Court of Appeals below was correct in concluding that they were not.

In *Phelps*, the Court held that where an IRS levy had been made upon an assignee for benefit of creditors in possession of

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[11] e.g. "Thus, a levy virtually transfers ownership of seized property to the government" Pet. Br., at 25.

[12] Pet. Br. point C(2), at 32-36.

[13] *United States v. Eiland*, 223 F.2d 118 (4th Cir. 1955) *United States v. Pittman*, 449 F.2d 623 (7th Cir. 1971).

$38,000.00, as proceeds of the liquidation of a taxpayer's assets, in order to collect $140,831.59 in delinquent taxes, a bankruptcy receiver appointed under the former Bankruptcy Act, in an involuntary proceeding commenced after the levy, could not obtain a turnover of the $38,000.00 from the assignee for benefit of creditors over the opposition of the IRS. In so holding, the Court found that the IRS levy placed the funds in the "constructive possession" of the IRS although retained by the assignee. Having such pre-petition possession adversely held for the benefit of the government, "the holder [i.e. the assignee] is not subject to summary jurisdiction [of the Bankruptcy Court]" 421 U.S. 335-6, *quoting with approval* 2 J. Moore & R. Oglebay, *Collier on Bankruptcy* ¶23.06 [3], pp. 506.2-506.3 (14th ed. 1975).

Four salient facts existed in the *Phelps* case which had a substantial bearing not only upon the decision in the case but upon the language used by the court in its opinion. Those facts are:

1. The case was decided under the Bankruptcy Act of 1898, as amended.

2. The bankruptcy proceeding at issue was a "straight bankruptcy" or liquidation case.

3. The debt owed the government was more than 3-1/2 times the value of the fund in the hands of the assignee.

4. The collateral at issue consisted solely of money in the hands of the assignee.

The first two facts relate to the prior settled law that, in a liquidation case under the Bankruptcy Act, the jurisdiction of the bankruptcy court over assets of the bankrupt extended only to those in the actual or constructive possession of the bankrupt on the date of the petition. 2 *Collier on Bankruptcy* ¶23.04[2] (14th ed. 1976). Unless this limitation on its so-called summary jurisdiction were waived by such a party,[14] the bankruptcy

[14] In *Phelps* the court specifically found that no such waiver had been made by the IRS. 421 U.S. 336, n.6

court could not acquire jurisdiction over assets adversely held by a third party under claim of right. *Cline v. Kaplan*, 323 U.S. 97 (1944), see also 2 *Collier on Bankruptcy* ¶23.04[2] (14th ed. 1976).

Thus, where a mortgagee had commenced foreclosure in state court before the petition, the bankruptcy court in a liquidation case under the Act had no jurisdiction over the real property being foreclosed, nor did Bankruptcy Rule 601(a) (1) stay such a proceeding. 13 *Collier on Bankruptcy* ¶601.05[2-1.1] (14th ed. 1977).

This limitation of jurisdiction was in marked contrast to the jurisdiction of the bankruptcy court in a Chapter X, Chapter XI, or Chapter XII case under the Act where possession at the time of the petition was irrelevant to the court's jurisdiction which extended to the debtor's property "wherever located."[15] Although a turnover power was expressly granted to a trustee or debtor-in-possession in a Chapter X[16] or Chapter XII[17] case, the absence of a specific grant in Chapter XI[18] cases may

[15]Bankruptcy Act §§111 (Chapter X), 311 (Chapter XI), 411 (Chapter XII); Act of June 22, 1938, ch. 575, 52 Stat. 840 *et. seq.*, §§111, 311, 411; 11 U.S.C. §§511, 711, 811.

[16]Bankruptcy Act §257, Act of June 22, 1938, ch. 575, §1, 52 Stat. 902; 11 U.S.C. §657.

[17]Bankruptcy Act §507, Act of June 22, 1938, ch. 575, §1, 52 Stat. 927; 11 U.S.C. §907.

[18]The absence of a turnover provision comparable to §257 or §507 in Chapter XI of the Bankruptcy Act can be explained by the fact that an arrangement under Chapter XI could affect only the rights of unsecured creditors. The status of security holders was to remain unaltered. Bankruptcy Act §§306(1), 356, Act of June 22, 1938, ch. 575 §1, 52 Stat. 840, *et. seq.*, §§306(1), 356, 11 U.S.C. §§706(1), 756; *Securities & Exchange Comm'n. v. United States Realty & Improvement Co.*, 310 U.S. 434 (1940). As a creditor holding assets of the debtor at the time of the filing of a petition would not be unsecured, a turnover provision would have served no useful purpose as Chapter XI was not intended to affect that creditor's pre-petition status.

have been the deciding, although unexpressed, factor in the decision of the Third Circuit in *In re Pittsburgh Penguins Partners*, 598 F.2d 1299 (3d Cir. 1979) which, in following *Phelps*, held that a pre-petition tax levy divested the bankruptcy court, in a subsequent Chapter XI case, of summary jurisdiction over the funds levied upon.[19]

As the Court of Appeals below noted,[20] the distinction between summary jurisdiction and plenary jurisdiction, which was critical to the *Phelps* holding that the bankruptcy court in *Phelps* lacked *summary* jurisdiction over the fund at issue, no longer exists under the Bankruptcy Code, as Congress opted for a more expansive jurisdiction grant, 28 U.S.C. §1471(e), patterned upon §111 of Chapter X of the Bankruptcy Act. Most importantly, the Court of Appeals noted that *Phelps* did not decide that a bankruptcy court would not have had the power to order a turnover had *Phelps* been a Chapter X case rather than a straight bankruptcy case as no such restriction had ever been judicially imposed in any reported case under the reorganization provisions of §§77 and 77B, Chapter X or Chapter XII.[21] The generally expanded jurisdiction in the bankruptcy court under 28 U.S.C. §1471(e), when coupled with the broadly stated turnover power under §542(a),[22] clearly

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[19]Thus the funds were held to be subject to IRS claims for penalties and post-petition interest notwithstanding the fact that neither would be allowed the IRS as part of a claim in the Chapter XI case.

[20]Pet. App. at 25a.

[21]Pet. App. 26a, quoting 6 *Collier on Bankruptcy* §3.05 at 431 (14th ed. 1977). *United States v. Eiland* and *United States v. Pittman*, both noted *supra*, were straight bankruptcies, while *In re Pittsburgh Penguins Partners, supra*, was a Chapter XI case.

[22]Turnover applies to all "entities" under §542(a) and extends to all "property that the trustee may use, sell or lease" rather than just to "all property of the debtor in the possession of a trustee under a trust deed or a mortgagee under a mortgage." Bankruptcy Act §257, *supra* note 16.

justifies the Court of Appeals' conclusion that *Phelps* is not precedent for the facts in the present case.[23] As no pre-Code cases exist as precedent for the exercise by a reorganization court of a turnover power against the Internal Revenue Service, the Court of Appeals was entirely correct in searching for available precedent under the Bankruptcy Act and finding such precedent in *Reconstruction Finance Corporation v. Kaplan*, 185 F.2d 791 (1st Cir. 1950) and related cases. Such precedent is now made relevant to turnover against the government by virtue of §106(c) of the Bankruptcy Code which makes any Code provisions applicable to an "entity" applicable to the government, "notwithstanding any assertion of sovereign immunity." As §542(a) applies to any "entity", it applies to the IRS. Under the Bankruptcy Act, however, no general waiver of sovereign immunity existed, and it is at least questionable whether turnover could have been compelled at all against the IRS under §257.[24] Accordingly, Bankruptcy Act turnover cases brought against the IRS may be of little or no precedential use at all under the Code.

Of the four salient facts in *Phelps* previously referred to, we have demonstrated our belief that the fact that *Phelps* arose under the Bankruptcy Act and the fact that it was a liquidation case makes *Phelps* irrelevant as precedent in this case. Under this analysis, we believe the Court of Appeals concluded correctly that the government was reduced to the argument that an IRS levy effects a transfer of ownership to the government

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[23] In so concluding, the court stated: "It is plain that the holding in *Phelps* does not assist the Government here." (Pet. App. 25a).

[24] cf. *In re American Boiler Works, Inc.*, 123 F. Supp. 352 (W.D.Pa. 1954), *aff'd.*, 220 F.2d 319 (3d Cir. 1955) which held that the absence of a specific reference to the United States in §70(e) of the Bankruptcy Act prevented the use of that section by a trustee to avoid a transfer made to the government by the bankrupt.

of the property seized, not just a transfer of possession.[25] The government makes it clear in its own brief that it bases its position on a claim of ownership.[26] The primary source of such a claim is two oft-quoted statements in *Phelps*, that the tax levy gave the United States "full legal right"[27] to the property levied upon and that "the pre-bankruptcy levy displaced any title of (the taxpayer)."[28]

We believe and respectfully submit that these statements of the court must be read in light of the third and fourth salient facts in *Phelps* previously referred to, i.e. that the debt owed IRS substantially exceeded the amount levied upon and that the collateral seized was money in the hands of a third party. In this respect the facts in *Phelps* are identical to the facts in *United States v. Eiland*,[29] *supra*, and even to those in *Cross Electric Company, Inc. v. United States, supra*.[30]

Had the property seized by IRS in *Phelps, Eiland,* or *Cross Electric* been tangible assets, rather than cash or a cash equivalent, there is no question but that the full panoply of procedures mandated by §6335 of the Internal Revenue Code of 1954 would have had to have been followed by IRS before a fund could be created from which the delinquent taxes could be

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[25]Pet. App. at 26a.

[26]Pet. Brief, at 25-26.

[27]421 U.S. 330, 337

[28]421 U.S. 330, 337 n.8

[29]$1,884.54 account receivable seized to satisfy IRS debt of $7,172.42.

[30]$5,672.65 account receivable seized to satisfy IRS debt of $43,297.15.

paid.[31] In such an event, it is clear that title to the seized property could not have passed to the government by the mere act of seizure under levy, for the Internal Revenue Code itself requires not only the conduct of an actual sale by public auction or by public sale under sealed bid,[32] it further directs the delivery of a certificate of sale to the purchaser[33] and, in addition, the delivery of a deed if the property sold is real property.[34] The certificate of sale acts as the conveyance document of the interest of the delinquent taxpayer in the property sold, if other than real property,[35] but the deed is the instrument of such conveyance if real property is sold.[36] The delivery of a deed to the United States is also mandated if the government is declared the purchaser of real property.[37]

Moreover, the fact that the taxes owed in *Phelps* exceeded the proceeds seized cannot be overlooked. Had the proceeds exceeded the taxes, it is inconceivable that the Court would have found the government to have "full legal right" to the entire proceeds or the bankrupt's title to be totally "displaced". It is similarly inconceivable that the holding in *Cross Electric* would not have changed had the tax owed been $5,672.65 rather than

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[31] Such procedures include: giving the "owner" notice of seizure §6335(a), giving the "owner" notice of sale §6335(b), fixing a time and place of sale within mandatory guidelines §6335(d), establishing a minimum price §6335(e)(1), prescribing the manner and conditions of sale §6335(e)(2), and reconducting the sale under certain conditions §6335(e)(3).

[32] Internal Revenue Code of 1954 §6335(e)(2)(a).

[33] Internal Revenue Code of 1954 §6338(a).

[34] Internal Revenue Code of 1954 §6338(b).

[35] Internal Revenue Code of 1954 §6339(a)(2).

[36] Internal Revenue Code of 1954 §6339(b)(2).

[37] Internal Revenue Code of 1954 §6338(c).

$43,297.15 and the levied upon account receivable $43,297.15, rather than $5,672.65.

Language to the effect, then, that a seizure under levy transfers "full legal right"[38] to the property, "displaces any title"[39] of the taxpayer, or is "tantamount to a transferal of ownership"[40] to the government can only be understood in the context of the seizure of incorporeal property having a value not in excess of the taxes owed, unlike the inventory, equipment and other tangible property seized from Whiting in this case.[41] Indeed, where the property seized is cash or a debt owed the taxpayer, upon the delivery of the property to it by the third party against whom the levy was made, the government would merely apply the property seized in reduction of the tax debt, the sale procedures of I.R.C. §6335 being unnecessary to reduce the property to cash. As the court in *Phelps* held the assignee for benefit of creditors to be a "custodian for the United States"[42] without personal interest in the proceeds, the possession of the proceeds by the assignee rather than the

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38 *Phelps v United States*, 421 U.S. 330, 337.

39 *Phelps v. United States*, 421 U.S. 330, 337 n.8.

40 *United States v. Sullivan*, 333 F.2d 100, 116 (3d Cir. 1964) involving the seizure of contract rights (cash surrender values) under life insurance policies.

41 Pet. Brief, Statement, p.2; Pet. App. 2a. Although the government asserts that the value of the property seized was only $35,000.00 (Pet. Brief, p. 25 n.15), that was the amount that the bankruptcy court found might be realized by the IRS on a distress sale (Pet. App. 36a), a fact relevant only to the issue of adequate protection. The bankruptcy court further found the going concern value of the property to be $162,876.00, an amount substantially in excess of the delinquent taxes. (Pet. App. 35a).

42 421 U.S. 330, 333. This custodial relationship was sufficient for the Court to find that the United States was in "adverse possession" of the proceeds, thus defeating the bankruptcy court's summary jurisdiction over the proceeds.

government would have been immaterial to the legal rights of the government in the proceeds under the law as it then existed. Whether this would continue to be true in a case arising on the *Phelps* facts under the Bankruptcy Code is less clear. It is possible that the assignee for benefit of creditors would be held to be a "custodian" subject to turnover under Bankruptcy Code §543.[43]

As we have shown, then, *Phelps* and the other pre-Bankruptcy Code decisions on IRS turnover to trustees or receivers are not of precedential value in interpreting turnover under the Code, nor is the "ownership" language in such cases applicable to the facts in the present case.

D. *The Court Of Appeals Properly Rejected The Government's Strained And Over Literal Construction Of §§542(a), 541(a) (1) And 363 Of The Bankruptcy Code.*

The government argues that the "plain meaning" of the relevant statutory language dictates that the "property of the estate" subject to turnover consists solely of the debtor's interest in property as of the commencement of the case. Pet. Br. at 19, 39-40. In our view, the Court of Appeals was justified in rejecting the government's over literal and formalistic construction in favor of a construction consistent with the purposes and policies of the Bankruptcy Code.

The starting point in statutory construction must, of course, be the language employed by Congress. e.g., *Reiter v. Sonotone Corp.*, 442 U.S. 330, 337 (1979). Under the "plain meaning" rule of statutory construction, where the language is

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[43]A "Custodian" is required by §543(b)(1) to "deliver to the trustee any property of the debtor transferred to such custodian, or proceeds of such property, that is in such custodian's possession, custody or control . . . ." the bankruptcy court below found the IRS in this case to be a "custodian" and directed turnover under §543. (Pet. App. 41a). Both the District Court (Pet. App. 10a) and the Court of Appeals (Pet. App. 10a) disagreed with the bankruptcy court on this point.

clear and a literal construction produces a reasonable result consistent with the legislative intent, the court will not look beyond the language to extrinsic sources. See, e.g., *American Tobacco Co. v Patterson*, ___ U.S. ___ 102 S.Ct. 1534, 1537 (1982); *Consumer Product Safety Comm'n v. GTE Sylvania Inc.*, 447 U.S. 102, 108 (1980). But the plain meaning rule is "rather an axiom of experience than a rule of law," *Boston Sand Co. v. United States*, 278 U.S. 41, 48 (1928), and, as such, does not bar a court from looking beyond the superficial meaning of words in a statute to a consideration of the circumstances of the particular enactment. See, *Watt v. Alaska*, 451 U.S. 259, 266 (1981); *Train v. Colorado Public Interest Research Group*, 426 U.S. 1, 10 (1976); *United States v. American Trucking Assns.*, 310 U.S. 534, 543-544 (1940).

> When aid to construction of the meaning of words as used in a statute, is available, there certainly can be no "rule of law" which forbids its use, however clear the words may appeal on "superficial examination" . . . . Obviously there is danger that the court's conclusion as to legislative purpose will be unconsciously influenced by the judges' own views or by factors not considered by the enacting body. A lively appreciation of the danger is the best assurance of escape from its threat, but hardly justifies an acceptance of a literal interpretation dogma which withholds from the courts available information for reading a correct conclusion. A few words of general connotation appearing in the text of statutes should not be given a wide meaning, contrary to a settled policy, "excepting as a different purpose is plainly shown." (footnotes omitted).

Id., at 543-544; *quoted in United States v. Security Industrial Bank*, ___ U.S. ___, 103 S.Ct. 407, 414 n.12 (1982).

As a preliminary matter, the government's argument that the "plain meaning" of the relevant statutes conflicts with the Second Circuit's construction suffers from an inherent ambiguity in the pivotal phrase "property of the estate", as

employed in §363 of the Bankruptcy Code. The ambiguity derives from the fact that the drafters of §363 plainly envisioned both the existence of other parties with interests in the "property of the estate", *see*, 11 U.S.C. (Supp. IV) §363(a), (e), (f), and the *use*, by the trustee or debtor-in-possession, of encumbered property, *see*, 11 U.S.C. (Supp. IV) §363(c); H.R. Rep. No. 95-595, 95th Cong., 1st Sess., 181-182, 344-345 (1977); S. Rep. No. 95-989, 95th Cong., 2d Sess., 5, 55-56 (1978).[44] Thus it appears that the reference is to *items of property* capable of use and capable of being encumbered, rather than to the debtor's *interests in property*. Yet, as the government contends, the phrase "property of the estate", as employed in §541(a) (1) of the Bankruptcy Code is a defined term meaning "all legal or equitable interests of the debtor in property as of the commencement of the case." This ambiguity renders the plain meaning rule inapposite and itself justifies reference to the legislative history for clarification.

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[44]For example, the House Report, H.R. Rep. No. 95-595, *supra*, at 181, states that:

> H.R. 8200 sets out in detail the rights of a trustee or a debtor in possession to use, sell, or lease property of the estate in the operation of the debtor's business in a reorganization case or in a winding-up operation in a liquidation case. These provisions are not found in the current Bankruptcy Act, but are governed by spotty case law. *The issue becomes most difficult when the property being used is collateral for a loan to the debtor. Then it is necessary to insure that the interest that the secured creditor has in the property is protected*, and that no erosion forbidden by the Constitution takes place. H.R. 8200 brings together the rules governing the use of such property, and provides protection for both the debtor, in the operation of the business, *and the secured creditor, in his interest in the property used.*
> (Emphasis added, footnotes omitted).

Both the House and Senate Reports, H.R. Rep. No. 95-595, *supra*, at 344; S.Rep. No. 95-989, *supra*, at 55, describe the purpose of §363 as follows:

> This section defines the right and powers of the trustee with respect to the use, sale, or lease of property *and the rights of other parties that have interests in the property involved.*

Even if this key language were not ambiguous, the plain meaning rule would have no application here. Where the plain meaning of the statutory language yields either absurd results, see, e.g. *United States v. Bryan*, 339 U.S. 323, 338 (1950); *Armstrong Co. v. Nu-Enamel Corp.*, 305 U.S. 315, 333 (1938); *United States v. Kirby*, 74 U.S. [7 Wall.] 482, 486 (1869), or an unreasonable result "plainly at variance with the policy of the legislation as a whole", *Ozawa v. United States*, 260 U.S. 178, 194 (1922), the reviewing court will look to the purposes and policies of the statute as revealed by the legislative history rather than slavishly adhere to the literal import of the words. *See, e.g., United Steelworkers of America vs. Weber*, 443 U.S. 193, 201-202 (1979); *United States v. American Trucking Assns.*, 310 U.S. 534, 543, *supra; Helvering v. Hammel*, 311 U.S. 504, 510-511 (1941). Reference to the purposes and policies of the Bankruptcy Code is particularly appropriate, since the courts construing the predecessors to the Code have traditionally eschewed "narrow formalistic interpretations which disregard the spirit and letter of the [statute]", *Wright v. Union Central Life Ins. Co.*, 311 U.S. 273, 279 (1940), in favor of a construction which effectuates the general remedial purpose and policy of the bankruptcy statute. *See, e.g., Local Loan Co. v. Hunt*, 292 U.S. 234, 244-245 (1934); *Lines v. Frederick*, 400 U.S. 18, 19-20 (1970); *Segal v. Rochelle*, 382 U.S. 375, 379 (1966); *Wright v. Union Central Life Ins. Co., supra*, at 279; *Maynard v. Elliott*, 283 U.S. 273, 277 (1930); *Williams v. United States Fidelity & Guaranty Co.*, 236 U.S. 549, 554-555 (1915).

Here, the government's analysis yields an absurd and unreasonable result that conflicts with various policies of the Code. The government proceeds by inserting the §541(a) "definition" of "property of the estate" into §363 and, ultimately, into §542(a). Using this analysis, the government concludes that only the debtor's *interests in property* as they exist on the date the petition is filed are subject to turnover

under §542(a) of the Bankruptcy Code. Pet. Br. at 14-19. It follows from this analysis that §542(a) of the Bankruptcy Code would literally require an entity "in possession, custody or control" (11 U.S.C. (Supp. IV) §542(a)) of "legal or equitable interests of the debtor in property" (11 U.S.C. (Supp. IV) §541(a) (1)) to deliver those *interests* to the trustee. The government fails to explain, however, how a debtor's *interest* in property could be in the "possession, custody or control" of a third party, how "delivery" of an *interest* could be accomplished, or why the trustee would need the turnover power to bring property *interests* into the bankruptcy estate, when that is already accomplished by §541(a) (1) of the Bankruptcy Code. Since the government must concede that the turnover power is intended as a mechanism for the physical recovery of items of property in the hands of third parties,[45] the result yielded by the government's analysis is both strained and absurd.

As will be discussed more fully in subsequent portions of this brief, the result yielded by the government's strained construction fundamentally conflicts with the rehabilitative purpose of the reorganization chapter of the Code by depriving the debtor-in-possession of the use of any property which has been repossessed by a secured creditor or levied upon by the government, without regard to the debtor's equity in that property, or the impact on reorganization. Where, as here, virtually all the assets of the debtor have been seized prior to bankruptcy, the inevitable result of such a rule will be the failure of reorganization and the cessation of the business.

The view of the statutes taken by the Court of Appeals, by contrast, would promote reorganization while protecting the interests of the secured creditor in its collateral through the concept of adequate protection. *See,* 11 U.S.C. (Supp. IV)

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[45]Thus, the very title of Section 542 reads: "Turnover of property to the estate."

§§361, 363(b), (c) (1). The government's analysis reads adequate protection out of the Code, thereby ignoring the interrelationship between §363 and §542(a). No satisfactory explanation is offered by the government's analysis for the fact that §542(a) cross-references to property that may be used, sold or leased under §363, rather than directly to the definition of "property of the estate" in §541(a). The logical answer is that Congress intended that the turnover authority, like the power to use, lease and sell property of the debtor, would be limited by the concept of adequate protection. *See, e.g.*, 4 *Collier on Bankruptcy* ¶542.02 (15th ed. 1982). It follows, therefore, that Congress contemplated that the turnover power would be used to recover property in which a creditor retained an interest warranting adequate protection. While the Second Circuit's view of the statute takes adequate protection into account, the government's view turns solely on the debtor's non-bankruptcy right to possession of property, and would deny turnover whether or not the repossessing creditor's interest could be adequately protected. Thus, the government's analysis violates the admonition that all parts of a statute should be construed together so as to produce a harmonious whole. *See*, C. Sands, 2A *Sutherland on Statutes and Statutory Construction*, §46.05 (4th ed. 1973).

E. *The Legislative History Compels The Conclusion That §542(a) Of The Bankruptcy Code Was Intended By Congress As a Codification Of the Broad Turnover Power Existing In Chapters X And XII Of The Bankruptcy Act.*

Having correctly discerned that the government's construction of the statutory scheme "would have a far-reaching effect on reorganizations by denying to debtors and trustees in reorganization not only the power to obtain the turnover of property of the debtor levied upon by the IRS, but also that repossessed prior to bankruptcy by secured creditors or held by pledgees after a default", *United States v. Whiting Pools, Inc.*,

674 F.2d 144, 150, *supra;* Pet. App. at 12a-13a, the Second Circuit next considered whether such a drastic result is compatible with the intent of Congress as revealed in the legislative history of §542(a), *Id.*, at 150-156; Pet. App. at 13a-23a. Placing primary reliance on the derivation of §542(a) during the legislative process, as clarified by the statements of various witnesses at the legislative subcommittee hearings, the Court of Appeals concluded that §542(a) was intended to give a bankruptcy court in a reorganization proceeding under Chapter 11 of the Bankruptcy Code the same broad turnover power available in reorganization proceedings under Chapter X and XII of the former Bankruptcy Act of 1898, *Id.*

The fundamental problem facing the Second Circuit in its attempt to ascertain the congressional intent from the legislative history of §542(a) was the absence of an unequivocal statement in either the House or Senate Committee Reports or in the Floor debates concerning the power of the bankruptcy court to order turnover of property that had been repossessed by a secured creditor before bankruptcy. Thus, for example, in their discussion of §542, the House and Senate Reports merely state that:

> Subsection (a) of this section requires anyone *holding property of the estate* on the date of the filing of the petition, or property that the trustee may use, sell or lease under section 363, to deliver it to the trustee . . . . The *holder of the property of the estate* is excused from the turnover requirement of this subsection if *the property held* is of inconsequential value to the estate. (Emphasis added).

H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 369 (1977); S. Rep. No. 95-989, 95th Cong., 2d Sess. 84 (1978).[46] This

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[46]Similarly, during the final debates on the Compromise Bill, H.R. 8200, the floor managers of the House and the Senate each described the purpose of Section 542(a) in terms which merely track the statutory language:

Footnote continued on next page—

statement is susceptible to two variant interpretations depending on whether the words "property of the estate" are intended to refer to items of property in which the bankruptcy estate has an interest or to those interests themselves. Because of this inherent ambiguity, this and similar statements in the legislative history provide little actual guidance as to the intended scope of the turnover power.

The clearest statement of congressional intent regarding the scope of §542(a) appears in the discussion in the House and Senate Committee Reports of the kinds of property that become property of the estate under §541(a)(1), where it is written that:

> The scope of this paragraph is broad. It includes all kinds of property, including tangible or intangible property, causes of action (see Bankruptcy Act §70a(6)), and all other forms of property currently specified in section 70a of the Bankruptcy Act §70a, *as well as property recovered by the trustee under section 542 of proposed title 11, if the property recovered was merely out of the possession of the debtor, yet remained "property of the debtor."* The debtor's interest in property also includes "title" to property, which is an interest, just as are a possessory interest, or leasehold interest, for example. (emphasis added).

H.R. Rep. No. 95-595, *supra*, at 367. S. Rep. No. 95-985, *supra* at 82. The authors of this passage treated turnover under §542(a) as an independent bankruptcy power rather than as a mere adjunct to §541(a)(1). This strongly suggests that items of

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—Footnote continued from preceding page

> The section makes clear that any entity, other than a custodian, is required to deliver property of the estate to the trustee or debtor in possession whenever such property is acquired by the entity during the case, if the trustee or debtor in possession may use, sell, or lease the property under section 363, or if the debtor may exempt the property under section 522, unless the property is of inconsequential value or benefit to the estate.

124 Cong. Rec. 32399-32400 (1978) (Statement of Rep. Edwards); 124 Cong. Rec. 33999 (1978) (Statement of Sen. DeConcini).

property out of the possession of the debtor may be brought into the bankruptcy estate by exercise of the turnover power if the debtor retained a non-possessory interest in those items of property. The reference to property recovered under §542 would be totally superfluous if all that could be recovered by turnover was the debtor's possessory interests, since the passage makes it clear that such possessory interests are brought directly into the bankruptcy estate by §541(a)(1).

While the above statement from the House and Senate Committee Reports supports an inference that Congress intended that the turnover power could reach "property of the debtor" in the rightful possession of third parties, it makes no explicit mention of secured creditors and thus cannot be considered conclusive.

Having found no conclusive statements of congressional intent in the committee reports or legislative debates, the Court of Appeals considered the genesis of §542(a) during the legislative process.[47] *United States v. Whiting Pools, Inc.*, 674

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[47]Given the inconclusiveness of the committee reports and legislative debates, the Court of Appeals was plainly justified in looking to the congressional hearings for guidance. See, e.g. *Dawson Chemical Co. v. Rohm & Haas Co.*, 448 U.S. 176, 202-213, *rehearing den.*, 448 U.S. 917 (1980); *Corning Glass Works v. Brennan*, 417, U.S. 188, 198-201 (1974); *United States v. American Trucking Assns.*, 310 U.S. 534, 548-549 (1940); See generally, C. Sands, *Sutherland on Statutes and Statutory Construction* §48.10, at 209-210 (4th ed. 1973). Just as there is no rule of law which forbids a court from recourse to available extrinsic aids in construing a statute, e.g., *United States v. American Trucking Assns., supra*, at 543-544, there is no rule of law which would require a court to give absolute priority to inconclusive statements and generalizations in committee reports or legislative debates over other extrinsic aids, compare *Corning Glass Works v. Brennan, supra*, with *United States v. International Union, United Automobile Workers*, 352 U.S. 567, 585 (1957). To paraphrase Justice Marshall in *Corning Glass Works v. Brennan, supra* at 198:

> "[I]n this case, a better understanding of [the language of Section 542(a)] can be obtained from a consideration of the way in which Congress arrived at the statutory language than from trying to reconcile or establish preferences between the conflicting interpretations of the [Code] by individual legislators or the committee reports."

F.2d 144, 152-153, *supra;* Pet. App. at 17a-18a. Neither §542(a), nor any comparable turnover provision, appeared in either the bankruptcy legislation proposed by the Commission on the Bankruptcy Laws of the United States, H.R. 31, 94th Cong., 1st Sess. (1975); S. 236, 94th Cong., 1st Sess. (1975) or the competing proposal of the National Conference of Bankruptcy Judges, H.R. 32, 94th Cong., 1st Sess. (1975); S. 235, 94th Cong., 1st Sess. (1975).[48] §542(a) first appeared in H.R. 6, 95th Cong., 1st Sess. (1977), a bill drafted by the staff of the Subcommittee on Civil and Constitutional Rights of the House Judiciary Committee following extensive subcommittee hearings on H.R. 31 and H.R. 32[49] and intensive consultations with bankruptcy experts from the National Bankruptcy Conference and the National Conference of Bankruptcy Judges, 123 Cong. Rec. 35448 (1977) (Remarks of Rep. Butler);

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[48]The legislative process which culminated in the enactment of the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, began with the introduction in 1973 of legislation proposed in the REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. Doc. 93-137, 93d Cong., 1st Sess. (1973), as H.R. 10792, 93d Cong., 1st Sess. (1973), and S. 4026, 93d Cong., 1st Sess. (1973). See Klee, *Legislative History of the New Bankruptcy Code,* 54 Am. Bankr. L.J., 275, 277-278 (1980). This proposed legislation was reintroduced in the 94th Congress as H.R. 31 and S.236. *Id.* at 278-279. A competing bill proposed by the National Conference of Bankruptcy Judges was introduced in 1974 as H.R. 16643, 93d Cong., 2d Sess. (1974), and reintroduced in 1975 as H.R. 32 and S. 235.

These early drafts each contained turnover provisions comparable to §543 of the Bankruptcy Code, which were limited to property in possession of "custodians". H.R. 31, S .236, §4-603; H.R. 32, S. 235 §4-603.

[49]Thirty-five days of hearings were held before the House subcommittee between May of 1975 and May of 1976. *Hearings on H.R. 31 & H.R. 32 Before the Subcomm. on Civil & Constitutional Rights of the House Comm. on the Judiciary,* 94th Cong., 1st & 2d Sess. (1975-1976). The corresponding Senate Subcommittee also held twenty-one days of hearings on S. 235 and S. 236 between February and November of 1975. *Hearings on S. 235 & 236 Before the Subcomm. on Improvements in Judicial Machinery of the Senate Comm. on the Judiciary,* 94th Cong., 1st Sess. (1975).

Klee, *supra,* note 12, at 280. *See generally,* H.R. Rep. No. 95-595, *supra,* at 2-3. The language of Subsection (a) of §542 was incorporated into H.R. 6 in its present form, and no subsequent amendments were made during the legislative process. Thus, the Court of Appeals below, perceiving that the drafters of H.R. 6 had the benefit of the hearing transcripts in resolving the problems that had been identified at the hearings and elsewhere, found this chronology to be highly significant. *United States v. Whiting Pools, Inc.*, 674 F.2d 144, 153, 155; Pet. App. at 18a, 22a-23a. Based on this chronology, Judge Friendly reviewed the hearing transcripts for statements concerning the turnover power. *Id.* at 153; Pet. App. at 18a.

The hearing transcripts proved quite illuminating. Each of the witnesses who addressed the subject of turnover of collateral from secured creditors pointed out to the subcommittee that neither H.R. 31 nor H.R. 32 contained an express statutory grant of turnover authority that could compel the surrender of repossessed collateral by a secured creditor, and each recommended redrafting to rectify this oversight. See, *Hearings on H.R. 31 & H.R. 32 Before the Subcomm. on Civil & Constitutional Rights of the House Comm. on the Judiciary,* 94th Cong., 1st Sess., Part 1 at 439 (1975) (Prepared statement of Patrick A. Murphy, Esq.); *Hearings on H.R. 31 & H.R. 32, supra,* 94th Cong., 1st & 2d Sess., Part 2 at 1023 (1976) (Prepared statement of Walter W. Vaughan on Behalf of American Bankers' Assn. and the Consumer Bankers' Assn.); *Hearings on H.R. 31 & H.R. 32, supra,* 94th Cong., 2d Sess., Part 3 at 1757 (testimony of Robert J. Grimmig on Behalf of American Bankers' Assn.); *Id.*, at 1838 (Prepared statement of Leon S. Forman on Behalf of the National Bankruptcy Conference). There was a consensus among these witnesses that the turnover power present in reorganization cases under Chapters X and XII of the Bankruptcy Act should, given the expanded jurisdiction of the bankruptcy under the proposed bills, be extended at least to reorganization courts under the

new statute.[50] See, e.g. *Id.*, at 1756-1757; 1838. The National Bankruptcy Conference (NBC), whose opinion should be accorded especial weight in light of the direct participation of NBC representatives in the drafting of H.R. 6, see 123 Cong. Rec. 35448 (1977), recommended that "the right to gain possession from a secured creditor should exist in both liquidation and reorganization cases" and offered a proposed amendment to §4-603 of H.R. 31 and H.R. 32 which would have made that provision applicable to both custodians and "creditors".[51] *Hearings on H.R. 31 and H.R. 32,* 94th Cong., 2d Sess., Part 3 at 1838-1839.

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[50]Thus, for example, Patrick A. Murphy testified that the standard for turnover under the new consolidated reorganization chapter should be that "the jurisdiction of the bankruptcy court extends to property of the estate 'wherever located' without regard to whether it has been taken possession of by a secured creditor." *Hearings on H.R. 31 & 32,* 94th Cong., 1st Sess., Part 1 at 488. Explaining his reasons for advocating an express turnover authority applicable in reorganization cases, Murphy testified that:

> "In any chapter proceeding, that is in any rehabilitative proceeding, I can accept the need both for a stay over the collateral without regard as to who has possession and for, in appropriate circumstances, court authority to order the surrender for use in the rehabilitative process. I recognize that the latter power, which is present in at least Chapter X and XII of the existing law, should be exercised only in the most careful manner and after express findings by the court that no harm to the creditor will result by reason of the turnover of the property. I think it is vital that this power exist in the court because this is one of the examples of the advantage creditors may obtain in the weeks prior to bankruptcy by repossession or the appointment of a receiver with respect to collateral."

Id. at 489.

[51]The government discounts the input of the National Bankruptcy Conference on the ground that Congress did not adopt the proposed amendment to §4-603 of H.R. 31. Pet. Br. at 43. This ignores the fact that the substance of the NBC proposal suddenly appeared in H.R. 6 as a new turnover statute, Section 542(a). Although Congress did not adopt the specific language proposed by the NBC and did not choose to create one omnibus turnover provision, that does not destroy the inference that Section 542(a) was promulgated in response to recommendations made by the NBC witnesses and other at the House Hearings.

The fact that every witness to address the question of the scope of the turnover power recommended to the subcommittee that the proposed bankruptcy legislation be amended to explicitly incorporate the broad turnover power then existing under Chapter X, see, e.g., *Reconstruction Finance Corp. v. Kaplan*, 185 F.2d 791 (1st Dir. 1950), and Chapter XII of the Bankruptcy Act, see, e.g., *In Re Colonial Realty Investment Co.*, 516 F.2d 154 (1st Cir. 1975),[52] combined with the sudden appearance of a totally new turnover provision, §542(a), in the draft prepared immediately after those hearings[53] gives rise to a strong inference that §542(a) was intended to codify the broad turnover power universally advocated by those witnesses. No alternative explanation of the origin of §542(a) of the

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[52]One of the witnesses, Patrick A. Murphy, was also the author of an article critical of the proposed legislation's failure to expressly deal with the power of the bankruptcy court to recover property from secured creditors in possession. See, Murphy, *Use of Collateral in Business Rehabilitation: At Suggested Redrafting, of Section 7-203 of the Bankruptcy Reform Act*, 63 Calif. L. Rev. 1483, 1497-1498 (1975). This article was made a part of the hearing record, *Hearings on H.R. 31 and H.R. 32, supra*, 94th Cong., 2d. Sess., Part 3 at 1775, as were other articles reviewing the case law concerning the use and turnover of a secured party's collateral (including *Reconstruction Finance, supra*). See Coogan, Broude & Glatt, *Comments on Some Reorganization Provisions of the Pending Bankruptcy Bills*, 30 Bus. Law. 1149, 1169-1178 (1975), *reprinted in, Hearings on H.R. 31 & H.R. 32, supra*, 94th Cong., 1st Sess., Part 1, at 398; Murphy, *Restraint and Reimbursement: The Secured Creditor in Reorganization and Arrangement Proceedings*, 30 Bus. Law. 14, (1974) *reprinted in, Hearings on H.R. 31 & H.R. 32, supra*, 94th Cong., 1st Sess., Part 1, at 442.

[53]The House hearings were completed in May of 1976 and drafting of H.R. 6 began one month later. 23 Cong. Rec. 35448 (1977). On October 1, 1976, a preliminary draft was sent to the National Bankruptcy Conference and the National Conference of Bankruptcy Judges for review and comment. *Id.* From November to December of ;976, representatives of those two groups met extensively with congressional staff members to discuss the form the new draft should take. *Id.* In all, 13 full days of meetings were held. *Id.* The final version of H.R. 6 was introduced in the House of Representatives on January 4, 1977. *Id.*

Bankruptcy Code is offered by the government.[54] Thus, as the Court of Appeals found, the circumstances under which §542 was drafted compel "the inference that §542 was added to the Code to make clear — as a number of witnesses had explicitly urged — that the turnover power approved in *RFC v. Kaplan* was to be incorporated in the new statute."[55] *United States v. Whiting Pools, Inc.*, 674 F.2d 144, *supra*, at 155; Pet. App. at 23a.

Nevertheless, the government asserts that the legislative history supports a narrow view of the turnover power, relying primarily on general statements to the effect that §541(a)(1) "is not intended to expand the debtor's rights against others more than they exist at the commencement of the case", H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 369 (1977); S. Rep. No. 95-989, 95th Cong., 2nd Sess. 92 (1978), that "[i]f the debtor holds

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[54]The government speculates, without any support from the legislative history, that Section 542(a) is intended as a "general enforcement provision" codifying the judicially-created summary turnover procedure that existed under prior law, see *Maggio v. Zeitz*, 333 U.S. 56, 61-63 (1948). Pet. Br. at 44-45. Why Congress would suddenly deem it necessary to independently codify a turnover power implicit in the power of the bankruptcy court to issue orders necessary or appropriate to carry out the purposes of the Bankruptcy Code, see, 11 U.S.C. (Supp. IV) §105(a); 28 U.S.C. §1651 (All Writs Statute); *Maggio v. Zeitz, supra*, at 62, does not appear.

[55]This broad view of turnover under §542(a) is shared by commentators on the new Bankruptcy Code. See, 1 *Collier on Bankruptcy*, ¶3.01, at 3-56 (15th ed. 1982); Levit, *Use and Disposition of Property Under Chapter 11 of the Bankruptcy Code: Some Practical Concerns*, 53 Am. Bankr. L.J. 275, 283, n. 21 (1979); Moller & Foltz, *Chapter 11 of the Bankruptcy Code*, 58 N. Carolina L. Rev. 881, 902-903 (1980); Nowak, *Turnover Following Prepetition Levy of Distraint Under Bankruptcy Code §542*, 55 Am. Bankr. L.J. 313, 331-336 (1981); Orr & Klee, *Secured Creditors Under the New Bankruptcy Code*, 11 U.C.C. Law J. 312, 327-331 (1979); Reiley, *Secured Creditors and the Bankruptcy Act of 1978*, 14 U.S.F. L. Rev. 341, 352-353 (1980); Comment, *Bankruptcy and Turnover Proceedings Against the IRS: A Path Toward Reorganization and Rehabilitation Fraught with Pitfalls*, 4, Whittier L. Rev. 87, 122-124 (1982).

bare legal title or holds property in trust for another, only those rights which the debtor would have otherwise had emanating from such interest pass to the estate under Section 541", 124 Cong. Rec. 32399, 33999 (1978), and that "[t]o the extent such an interest is limited in the hands of the debtor it is equally limited in the hands of the estate. . . .", 124 Cong. Rec. 32399.

While the principle that the non-bankruptcy property rights acquired by the bankruptcy estate are generally limited to those held by the debtor at the commencement of the case is unassailable, neither that principle nor its various articulations in the legislative history are entitled to the controlling weight urged by the government.[56] Both the principle and the above statements relate to the composition of the bankruptcy estate under §541 of the Bankruptcy Code, not to the power of the bankruptcy court to displace a creditor in possession of property of the debtor and direct turnover pursuant to 11 U.S.C. (Supp. IV) §542(a). While it is true that the *non-*

[56]For example, the government points out that Congress deleted from the final legislation two proposed provisions, S.2266, 95th Cong., 2d Sess. §541(b)(1), (2) (1978), which would, respectively, have excluded from "property of the estate" property held by the debtor in trust for another and withholding taxes. 124 Cong. Rec. 32417, 34016-34017 (1978). The explanation given by the conference managers for the deletion was that these provisions were "unnecessary since property of the estate does not include the beneficial interest in property held by the debtor as a trustee." *Id.*

It is conceded that property held by the debtor as trustee, including "trust fund" taxes, *see*, 26 U.S.C. §7501, would not be property of the estate subject to turnover. Had the government established by tracing, *see, e.g., Slodov v. United States*, 436 U.S. 238, 256; *In re Rohar Associates*, 375 F. Supp. 637, 638-639 (S.D.N.Y. 1974); 4 *Collier on Bankruptcy*, ¶541.13 (15th ed. 1982); 2 G. Palmer *Restitution* §§2.14-19 (1978), that the assets seized by tax levy were the proceeds of trust funds, it would have had a defense to turnover. The government neither raised such a defense in the bankruptcy court, nor offered any proof that the tangible assets seized were traceable as the proceeds of "trust fund" taxes. Thus, the government's "trust fund" argument is irrelevant to this appeal, except as some support for the general principle that the bankruptcy estate does not acquire greater non-bankruptcy property rights than the debtor had.

possessory property interests of the debtor are not expanded upon inclusion in the bankruptcy estate, §542(a) provides an independent statutory grant to the bankruptcy trustee of a greater possessory right in bankruptcy than was held by the debtor prior to bankruptcy.

F. *A Construction Of Section 542(a) Which Would Deny The Bankruptcy Court The Power To Order Turnover Of Collateral In The Possession Of Secured Creditors And Property Seized By IRS Tax Levy Conflicts With The Policies Of The Bankruptcy Code, Particularly The Policy Favoring Successful Rehabilitation Of Business Debtors.*

Further support for the Second Circuit's conclusion that Congress intended §542(a) to be a codification and extension of the broad turnover power available under Chapters X and XII of the Bankruptcy Act can be found in the policies of the Bankruptcy Code.

Reconstruction Finance Corp. v. Kaplan, 185 F.2d 791, *supra*, was the leading case in a line of cases holding that, in reorganization proceedings under the Bankruptcy Act,[57] the bankruptcy court had the power to order turnover of assets of the debtor which had been lawfully repossessed by a secured creditor after default, where those assets were necessary for a successful reorganization.[58] In that case, after a Chapter X

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[57]"Reorganization" under the Bankruptcy Act, of course, was limited to Chapter X; Chapters XI and XII providing for more limited "arrangement" proceedings. The denomination of proceedings under Chapter 11 of the Bankruptcy Code as "reorganizations" is a meaningful choice of term.

[58]See, e.g., *Grand Boulevard Inv. Co. v. Strauss*, 78 F.2d 180 (8th Cir. 1935) [turnover of property in possession of mortgagee in §77B proceeding]; *In re Prudence-Bonds Corp.*, 77 F.2d 328 (2d Cir.), *cert. denied*, 296 F.2d 584 (1935) [turnover of rents and profits by mortgagee in §77B proceeding]; *John Hancock Mut. Life Ins. Co. v. Casey*, 134 F.2d 162 (1st Cir.) (per

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petition had been filed and a plan approved, the district court authorized the trustees to operate the business and directed the pledgee to deliver to the trustees all the property of the debtor in its possession. *Id.* at 793-794. The First Circuit affirmed the turnover order, finding the power to order turnover implicit in the broad grant of jurisdiction in §111 of the Bankruptcy Act over "the debtor and its property, wherever located" and the rehabilitative purpose of Chapter X.[59] *Id.* at 794-795.

The policy considerations which led the court in *Reconstruction Finance Corp. v. Kaplan* to take an expansive view of the jurisdiction of the reorganization court over property in the possession of secured creditors are equally applicable to Chapter 11 reorganization proceedings under the Bankruptcy Code. As the following passage from the House Committee Report illustrates, the goal of reorganization under the Bankruptcy Code remains the rehabilitation of business debtors, so as to preserve the going concern value of the business:

> The purpose of a business reorganization case, unlike a liquidation case, is to restructure a business's finances so that it may continue to operate, provide its employees with jobs, pay its creditors, and produce a return for its stockholders. The premise of a business reorganization

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curiam), *cert. denied*, 319 U.S. 757 (1943) [turnover of mortgaged premises and collected rents from mortgagee in Chapter X proceeding]; *In re. Franklin Garden Apartments, Inc.*, 124 F.2d 451 (2d Cir. 1941) [turnover of mortgaged premises and collected rents in Chapter X proceeding]; *In re Third Ave. Transit Co.*, 198 F.2d 703, 706 (2d Cir. 1952) [court acknowledged power to order turnover of cash from mortgage indenture trustee].

[59]The First Circuit also found support for a broad turnover power implicit in §257 of the Bankruptcy Act, which granted the bankruptcy trustee a right to possession of property held by mortgagees or trustees under a trust deed, but the decision of property held by mortgagees or trustees under a trust deed, but the decision did not rest on that ground. *Id.* at 795.

> is that assets that are used for production in the industry for which they were designed are more valuable than those same assets sold for scrap. Often, the return on assets that a business can produce is inadequate to compensate those who have invested in the business. Cash flow problems may develop, and require creditors of the business, both trade creditors and long-term lenders, to wait for payment of their claims. If the business can extend or reduce its debts, it often can be returned to a viable state. It is more economically efficient to reorganize than to liquidate, because it preserves jobs and assets.

H.R. Rep. No. 95-595, *supra*, at 220. Attainment of this rehabilitative goal is obviously dependent to a great extent on the ability of the trustee or debtor-in-possession to collect, retain and use the assets of the debtor in the operation of the business. See, 6 *Collier on Bankruptcy* ¶3.05, at 431 (14th ed. 1977). A broad turnover power capable of retrieving assets in the possession of secured creditors is thus as vital to successful reorganization under the Code as it was under Chapter X of the Bankruptcy Act.

In contrast, the narrow view of the turnover power advocated by the government conflicts with the rehabilitative purposes of the reorganization chapter[60] by permitting either the IRS or secured creditors, by precipitous action, to deny the trustee the use of the debtor's assets without regard to the extent of the debtor's equity in those assets. The drastic impact of such a rule on the prospects for successful rehabilitation of the debtor cannot be reconciled with the comments in floor debates by the House Sponsor of H.R. 8200 indicating that Congress intended to *encourage* reorganizations by in-

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[60]Sections 542(a), 541 and 363 of the Bankruptcy Code are, of course, general provisions applicable in liquidating bankruptcies and Chapter 13 proceedings as well as reorganizations. A similar conflict may exist in liquidation cases with a congressional policy favoring the use of assets in the winding up operation of the business, see generally 11 U.S.C. (Supp. IV) §§721; 363(c), but that need not be decided here.

corporating the *combined* reorganization powers available under Chapters X, XI and XII of the Bankruptcy Act into a single consolidated reorganization chapter under the Code.[61] Furthermore, the narrow view of the turnover authority espoused by the government is inconsistent with the expanded jurisdiction of the bankruptcy court under the Bankruptcy Code. Like §111 of Chapter X of the Bankruptcy Act, 28 U.S.C. §1471(e) vests the bankruptcy court with pervasive jurisdiction over all the property of the debtor wherever located. Given this broad jurisdictional grant, the inherent

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[61] During the House debate on the Compromise bill, Representative Edwards, a House sponsor and compromise manager, stated that:

> "The amendment also encourages business reorganizations by a streamlined new commerical reorganization chapter . . . . It will protect the investing public, protect jobs, and help save troubled business".

124 Cong. Rec. 32392 (1978).

In debates prior to the initial passage of H.R. 8200, Representative Edwards explained the reasons for consolidation of the three reorganization chapters of the Bankruptcy Act of 1898 into a single Chapter 11 under the Bankruptcy Code:

> "Now for businesses, we make it easier for them to repay their creditors, too . . . [N]one of the three chapters offers the full scope of bankruptcy powers that a business could use to reorganize and repay its creditors rather than going into straight bankruptcy, under which creditors usually get very little. . .
> We consolidate the three reorganization chapters into one flexible chapter. *It gives the debtors the combined powers of the three current chapters, and gives creditors the combined protection of the three chapters.* . . .
> This way creditors get more than if the business went into straight liquidation.
> It also will save more businesses, which will protect jobs and protect public and private investors."

123 Cong. Rec. 35446 (1977) [emphasis added].

During these same debates, Representative Rodino, Chairman of the House Judiciary Committee, observed that "[f]or businesses, the bill facilitates reorganizations, protecting investments, and jobs".
123 Cong. Rec. 35444 (1977).

power of a court of equity to protect its jurisdiction, see, *Continental Ill. Nat'l. Bank & Trust Co. v. Chicago, Rock Island & Pac. Ry.*, 294 U.S. 648, 675 (1935), the power granted by 11 U.S.C. (Supp. IV) §105 to make orders necessary to enforce the provisions of the Bankruptcy Code, and the power supplied by the "All Writs Statute" to issue writs in aid of its jurisdiction, see, 28 U.S.C. §1651(a), it is doubtful that the bankruptcy court would lack the power to order turnover of property in the possession of the IRS after a tax levy if the debtor retained an interest in that property.[62] This is especially so since the Government's reading of §§542(a), 541(a)(1) and 363 would in effect have jurisdiction turn on possession, while the House Committee report unequivocally declares that possession of the *res* is no longer relevant to jurisdiction under the Code, H.R. Rep. No. 95-595, *supra*, at 48-49.

Despite this expanded jurisdiction, if the government is correct in its rigid construction of the phrase "property of the estate", then under the Code, a bankruptcy court confronted with the facts of *Reconstruction Finance v. Kaplan* would be powerless to order turnover of the inventory.[63] The inevitable result could be the liquidation of a *solvent* debtor and con-

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[62]Bankruptcy Judge Hayes ruled that the IRS was subject to the automatic stay provision, 11 U.S.C. (Supp. IV) §362(a). Pet. App. at 34a-35a. The IRS never appealed from that aspect of the decision. Pet. App. at 50a, n.7; *United States v. Whiting Pools, Inc.*, 674 F.2d 144, 146, *supra;* Pet. App. at 3a. To that extent, the IRS has conceded that the bankruptcy court had jurisdiction over the assets in question.

[63]Arguably, the government's construction of "property of the estate" would also serve to overrule cases in which the secured creditor was denied reclamation of collateral from the debtor and the trustee or debtor-in-possession was authorized to use the collateral. See, e.g., *In re Bermec Corp.*, 445 F.2d 367 (2d Cir. 1971); *In re Yale Express Sys., Inc.* 370 F.2d 433 (2d Cir. 1966), *on remand*, 384 F.2d 990 (2d Cir. 1967). If the right to possession as of the commencement of the case is determinative of the right to use, sell or lease "property of the estate", then the secured creditor should be entitled to reclamation in any case in which there was a default pre-petition.

siderable economic loss, all to the detriment of the unsecured creditors, stockholders and employees of the debtor. Such a result is in irreconcilable conflict with the congressional policy favoring rehabilitation of business debtors, and could not have been intended by Congress.[64]

G. *Whiting is Entitled to the Turnover and Use of the Seized Property Under Section 542(a) if the United States can be Given Adequate Protection.*

The balancing of the respective interests of the debtor and the government in the seized property should not go to the issue of what percentage or which attributes of each item of property are "property of the estate". Rather, it should go to the issue of whether the debtor can use the property notwithstanding the substantial interest of the United States in the property. The debtor's right to use the property is determined by Bankruptcy Code §363. It is not determined by the Internal Revenue Code. The debtor's ability to use the property versus the United States' rights to sell the property concerns a dispute over remedies not over substantive or ownership rights. Accordingly, as the automatic stay provisions of §362(a) prevent an exercise of remedies by the United States and §363 grants the debtor the remedy of use of its property under certain circumstances, the question is which remedy should the Court provide, and to whom. Where, as here, the retention and sale of the

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[64] It must be presumed that Congress was aware of *Reconstruction Finance Corp. v. Kaplan* as a judicial construction of existing law. See, *Director, Office of Workers' Compensation Programs v. Perini North River Assoc.*, ___ U.S. ___ 103 S.Ct. 634, 649 (1983); *Cannon v. University of Chicago*, 441 U.S. 677, 696-697 (1979). In fact, when the drafters of the House and Senate Committee Reports gave an example of a circumstance in which authorization to operate a business should be granted in a liquidation case under 11 U.S.C. (Supp. IV) §721, the example chosen was "the operation of a watch company to convert watch movements and cases into completed watches which will bring much higher prices," a fact pattern taken from *Reconstruction Finance Corp. v. Kaplan*. H.R. Rep. No. 95-595, *supra*, at 380, S. Rep. No. 95-989, *supra*, at 94.

seized property by the Internal Revenue Service will put the debtor out of business and prevent any rehabilitation, it is appropriate for the Bankruptcy Court to use its equitable powers to fashion the remedy of "adequate protection"[65] for the United States while giving the debtor the remedy of the use of its property. This was exactly the course decided upon by the bankruptcy court below. (Pet. App. at 43a).

Although "adequate protection" is not a defined term under the Bankruptcy Code, examples are given in §361, including periodic cash payments to the affected creditor[66] and additional or replacement liens.[67] According to the legislative history of §361,[68] the concept derives from the Fifth Amendment protection of property interests and earlier decisions of this court[69] and, as the legislative history makes clear, the bankruptcy court is expected to utilize general equitable considerations to arrive at an appropriate judicial result on the facts of each case.[70]

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[65] §363(e) provides, in part, that . . . . "at any time, on request of an entity that has an interest in property used, sold, or leased, or proposed to be used, sold, or leased, by the trustee, the court shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest."

[66] §361(1).

[67] §361(2).

[68] House Report No. 95-595, 95th Cong., 1st Sess. 338-40 (1977); Senate Report No. 95-989, 95th Cong., 2nd Sess. 49, 53-54 (1978).

[69] *Wright v. Union Central Life Ins. Co.*, 311 U.S. 273, *supra*, and *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1935).

[70] See, e.g., House Report, *supra*, note 68, where it was stated:

> "It is expected that the courts will apply the concept in light of facts of each case and general equitable principles. It is not intended that the courts will develop a hard and fast rule that will apply in

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In the light, then, of the statutory provisions and the applicable legislative history, it is respectfully submitted that the better reasoned cases that have considered the issues involved in this lawsuit have focused their attention on whether or not the interests of the United States can be adequately protected if the seized property is turned over to the debtor-in-possession.[71] If the government's interests can be adequately protected, and unless the property is of "inconsequential value or benefit to the estate" (§542(a)), these cases would mandate a turnover to the debtor-in-possession. Such a determination is not automatic, however, for although the court in *Aurora* made such findings and ordered a turnover by the Internal Revenue Service, the court in *Hudson Valley* found a lack of adequate protection and denied turnover solely on that ground, and the courts in both *Alpa* and *Bristol* ordered further hearings on the issue of adequate protection.

In the present case, the bankruptcy court found not only that possession of the seized property was essential to Whiting's ability to function as a debtor-in-possession, but that, if turnover were directed, the interests of the government could be adequately protected. Accordingly the court structured specific conditions in its order so as to assure that the government's interests in the property would be adequately protected.[72]

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every case. The time and method of valuation is not specified precisely, in order to avoid that result. There are an infinite number of variations possible in dealings between debtors and creditors, the law is continually developing, and new ideas are continually being implemented in this field. The flexibility is important to permit the courts to adapt to varying circumstances and changing modes of financing."

[71]See, e.g. *In the Matter of Aurora Cord & Cable Company, Inc.*, 2 B.R. 342, *supra; Alpa Corporation v. IRS*, 7 B.C.D. 791, *supra; Bristol Convalescent Home, Inc. v. IRS*, 7 B.C.D. 1151, *supra; In re Hudson Valley Ambulance Service, Inc.*, 11 B.R. 860, *supra*.

[72]Pet. App. at 43a

The interpretation of the Bankruptcy Code sought by the government in this case, in effect, would eliminate the power of the bankruptcy court to perform the judicial function of determining and providing adequate protection as the counterbalance to turnover under §542(a). We believe that the concept of adequate protection was carefully inserted into the bankruptcy code in order to give the bankruptcy court needed flexibility to balance the interests of all parties involved in a reorganization case, thereby enabling the court to structure mechanisms to protect the pre-petition interests of creditors or lienors in the debtor's assets while permitting the debtor, as debtor-in-possession, to use those assets in its rehabilitation efforts. We believe that the counterbalance of adequate protection and turnover can work under appropriate judicial scrutiny, and that the bankruptcy court order of turnover, under the facts in this case, was consistent with the purpose and intent of the Bankruptcy Code.

CONCLUSION

For the reasons stated above, the order and decision of the court of appeals should be affirmed.

Respectfully submitted,

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APPENDIX A

STATUTES

Bankruptcy Code, 11 U.S.C. (Supp. IV):

§105 *Power of court*

(a) The bankruptcy court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.

§106. *Waiver of sovereign immunity*

(a) A governmental unit is deemed to have waived sovereign immunity with respect to any claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which such governmental unit's claim arose.

(b) There shall be offset against an allowed claim or interest of a governmental unit any claim against such governmental unit that is property of the estate.

(c) Except as provided in subsections (a) and (b) of this section and notwithstanding any assertion of sovereign immunity —

(1) a provision of this title that contains "entity", or "governmental unit" applies to governmental units; and

(2) a determination by the court of an issue arising under such a provision binds governmental units.

§361. *Adequate protection*

When adequate protection is required under section 362, 363, or 364 of this title of an interest of an entity in-property, such adequate protection may be provided by —

(1) requiring the trustee to make periodic cash payments to such entity, to the extent that the stay under

section 362 of this title, use, sale, or lease under section 363 of this title, or any grant of a lien under section 364 of this title results in a decrease in the value of such entity's interest in such property;

(2) providing to such entity an additional or replacement lien to the extent that such stay, use, sale, lease, or grant results in a decrease in the value of such entity's interest in such property; or

(3) granting such other relief, other than entitling such entity to compensation allowable under section 503 (b)(1) of this title as an administrative expense, as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property.

§363. *Use, sale, or lease of property*

(a) In this section, "cash collateral" means cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents in which the estate and an entity other than the estate have an interest.

(b) The trustee, after notice and a hearing, may use, sell or lease, other than in the ordinary course of business, property of the estate.

(c)(1) If the business of the debtor is authorized to be operated under section 721, 1108, or 1304 of this title and unless the court orders otherwise, the trustee may enter into transactions, including the sale or lease of property of the estate, in the ordinary course of business, without notice or a hearing, and may use property of the estate in the ordinary course of business without notice or a hearing.

(2) The trustee may not use, sell or lease cash collateral under paragraph (1) of this subsection unless —

(A) each entity that has an interest in such cash collateral consents; or

(B) the court, after notice and a hearing, authorizes such use, sale, or lease in accordance with the provisions of this section.

§543. *Turnover of property by a custodian . . .*

(b) A custodian shall —

(1) deliver to the trustee any property of the debtor transferred to such custodian, or proceeds of such property, that is in such custodian's possession, custody, or control on the date that such custodian acquires knowledge of the commencement of the case;

Internal Revenue Code, 26 U.S.C.:

§6332. *Surrender of property subject to levy*

(a) Requirement. Except as otherwise provided in subsection (b), any person in possession of (or obligated with respect to) property or rights to property subject to levy upon which a levy has been made shall, upon demand of the Secretary, surrender such property or rights (or discharge such obligation) to the Secretary, except such part of the property or rights as is, at the time of such demand, subject to an attachment or execution under any judicial process.

§6335. *Sale of seized property*

(a) Notice of seizure. As soon as practicable after seizure or property, notice in writing shall be given by the Secretary to the owner of the property (or, in the case of personal property, the possessor thereof), or shall be left at his usual place of

abode or business if he has such within the internal revenue district where the seizure is made. If the owner cannot be readily located, or has no dwelling or place of business within such district, the notice may be mailed to his last known address. Such notice shall specify the sum demanded and shall contain, in the case of personal property, an account of the property seized and, in the case of real property, a description with reasonable certainty of the property seized.

(b) Notice of sale. The Secretary shall as soon as practicable after the seizure of the property give notice to the owner, in the manner prescribed in subsection (a), and shall cause a notification to be published in some newspaper published or generally circulated within the county wherein such seizure is made, or, if there be no newspaper published or generally circulated in such county, shall post such notice at the post office nearest the place where the seizure is made, and in not less than two other public places. Such notice shall specify the property to be sold, and the time, place, manner, and conditions of the sale thereof. Whenever levy is made without regard to the 10-day period provided in section 6331(a), public notice of sale of the property seized shall not be made within such 10-day period unless section 6336 (relating to sale of perishable goods) is applicable.

(c) Sale of indivisible property. If any property liable to levy is not divisible, so as to enable the Secretary by sale of a part thereof to raise the whole amount of the tax and expenses, the whole of such property shall be sold.

(d) Time and place of sale. The time of sale shall not be less than 10 days nor more than 40 days from the time of giving public notice under subsection (b). The place of sale shall be within the county in which the property is seized, except by special order of the Secretary.

(e) *Manner and conditions of sale.*

(1) *Minimum price.* Before the sale the Secretary shall determine a minimum price for which the property shall be sold, and if no person offers for such property at the sale the amount of the minimum price, the property shall be declared to be purchased at such price for the United States; otherwise the property shall be declared to be sold to the highest bidder. In determining the minimum price, the Secretary shall take into account the expense of making the levy and sale.

(2) *Additional rules applicable to sale.* The Secretary shall by regulations prescribe the manner and other conditions of the sale of property seized by levy. If one or more alternative methods or conditions are permitted by regulations, the Secretary shall select the alternatives applicable to the sale. Such regulations shall provide:

(A) That the sale shall not be conducted in any manner other than —

(i) by public auction, or

(ii) by public sale under sealed bids.

(B) In the case of the seizure of several items of property, whether such items shall be offered separately, in groups, or in the aggregate; and whether such property shall be offered both separately (or in groups) and in the aggregate, and sold under whichever method produces the highest aggregate amount.

(C) Whether the announcement of the minimum price determined by the Secretary may be delayed until the receipt of the highest bid.

(D) Whether payment in full shall be required at the time of acceptance of a bid, or whether a part of such payment may be deferred for such period (not to exceed

1 month) as may be determined by the Secretary to be appropriate.

§6337. *Redemption of property*

(a) Before sale. Any person whose property has been levied upon shall have the right to pay the amount due, together with the expenses of the proceeding, if any, to the Secretary at any time prior to the sale thereof, and upon such payment the Secretary shall restore such property to him, and all further proceedings in connection with the levy on such property shall cease from the time of such payment.

(b) Redemption of real estate after sale.

(1) *Period.* The owners of any real property sold as provided in section 6335, their heirs, executors, or administrators, or any person having any interest therein, or a lien thereon, or any person in their behalf, shall be permitted to redeem the property sold, or any particular tract of such property, at any time within 120 days after the sale thereof.

§6338. *Certificate of sale; deed of real property*

(a) Certificate of sale. In the case of property sold as provided in section 6335, the Secretary shall give to the purchaser a certificate of sale upon payment in full of the purchase price. In the case of real property, such certificate shall set forth the real property purchased, for whose taxes the same was sold, the name of the purchaser, and the price paid therefor.

(b) Deed to real property. In the case of any real property sold as provided in section 6335 and not redeemed in the manner and within the time provided in section 6337, the Secretary shall execute (in accordance with the laws of

the State in which such real property is situated pertaining to sales of real property under execution) to the purchaser of such real property at such sale, upon his surrender of the certificate of sale, a deed of the real property so purchased by him, reciting the facts set forth in the certificate.

(c) Real property purchased by United States. If real property is declared purchased by the United States at a sale pursuant to section 6335, the Secretary shall at the proper time execute a deed therefor, and without delay cause such deed to be duly recorded in the proper registry of deeds.

§6339. *Legal effect of certificate of sale of personal property and deed of real property.*

(a) Certificate of sale of property other than real property. In all cases of sale pursuant to section 6335 of property (other than real property), the certificate of such sale —

(1) *As evidence.* Shall be prima facie evidence of the right of the officer to make such sale and conclusive evidence of the regularity of his proceedings in making the sale; and

(2) *As conveyances.* Shall transfer to the purchaser all right, title, and interest of the party delinquent in and to the property sold; and . . .

(b) Deed of real property. In the case of the sale of real property pursuant to section 6335 —

(1) *Deed as evidence.* The deed of sale given pursuant to section 6338 shall be prima facie evidence of the facts therein stated; and

(2) *Deed as conveyance of title.* If the proceedings of the Secretary as set forth have been substantially in

accordance with the provisions of law, such deed shall be considered and operate as a conveyance of all the right, title, and interest the party delinquent had in and to the real property thus sold at the time the lien of the United States attached thereto.

§6342. *Application of proceeds of levy . . .*

(b) Surplus proceeds. Any surplus proceeds remaining after the application of subsection (a) shall, upon application and satisfactory proof in support thereof, be credited or refunded by the Secretary to the person or persons legally entitled thereto.

28 U.S.C. §1471(e):

(e) The bankruptcy court in which a case under title 11 is commenced shall have exclusive jurisdiction of all of the property, wherever located, of the debtor, as of the commencement of such case.

All Writs Statute, 28 U.S.C. §1651(a):

§1651. *Writs*

(a) The Supreme Court and all courts established by Act of Congress may issue all writs necessary or appropriate in aid of their respective jurisdictions and agreeable to the usages and principles of law.